United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

To be argued by:
JESSE I. LEVINE

75-5011

United States Court of Appeals

For the Second Circuit.

In the Matter
of
NAT FAYE,
Bankrupt-Appellant,

KENNETH ZITTER,
Trustee-Appellee.

On Appeal From The United States District Court For The Southern District of New York

Appellant's Brief

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PRELIMINARY STATEMENT

This is an appeal from the Order of the Honorable Dudley B. Bonsal, United States District Judge for the Southern District of New York, dated May 15, 1975, which affirmed a finding of the Honorable Edward Ryan, Bankruptcy Judge, dated November 26, 1974, granting the petition of the trustee in bankruptcy and denying discharge to the bankrupt, Nat Faye, who is the appellant in this action, on the grounds that the bankrupt fraudulently concealed assets, and knowingly and fraudulently made a false oath in relation to the statement of affairs annexed to his petition for bankruptcy, and made a false oath in his testimony on the hearing of the trustee's petition.

ISSUES PRESENTED

(1) Did the trustee in bankruptcy sustain his burden of proof as to the allegation that the bankrupt knowingly and fraudulently made false oaths with respect to the scheduling of assets in his bankruptcy petition?

(2) Did the trustee sustain his burden of proof on the

allegation that the bankrupt made knowingly and fraudulently, a false oath in his testimony on the hearing of the trustee's petition?

(3) Were the findings of the Bankruptcy Judge, as affirmed by the District Court, clearly erroneous?

(4) Did the Bankruptcy Judge erroneously allow the trustee to prove his allegations by less than a constitutionally acceptable quantum of proof?

(5) Should this case be remanded to the Bankruptcy Judge for further proceedings in the interest of justice?

STATEMENT OF FACTS

Nat Faye (Bankrupt-Appellant) was adjudicated a bankrupt on his voluntary petition filed on September 15, 1971 (JA 246).[1] Kenneth Zitter (Trustee-Appellee) conducted an examination of Mr. Faye's statement of affairs as listed in his bankruptcy schedules. Based on this examination held on September 19, 1972, the Trustee alleged that the bankrupt may have committed acts that under the Bankruptcy Act would deny his discharge (JA4-6).

The Trustee filed three specifications of objections to discharge on October 15, 1972 (JA1-2) and subsequent hearings were conducted before Bankruptcy Judge Edward J. Ryan. In the first count, the Trustee alleged that the bankrupt knowingly and fraudulently omitted a diamond ring that his wife allegedly purchased "on memo" for approximately $15,000.00 from his schedule of assets, and if the allegation was true, such an intentional omission would constitute a violation of 18 U.S.C. §152, requiring a denial of discharge under §14c(1) of the Bankruptcy Act (11 U.S.C. §32) (JA-1).

In the second specification, the Trustee alleged that the bankrupt had failed to keep or preserve books of account or

1. Numbers in parentheses refer to pages of the Joint Appendix, unless otherwise indicated.

records from which his financial condition and business transactions might be ascertained (JA2). Such an allegation constitutes a violation of §14c(2) of the Bankruptcy Act. The Bankruptcy Court dismissed this allegation, and it is not part of this appeal (JA247).

In the third specification, the Trustee alleged that the bankrupt committed an offense punishable under 18 U.S.C. §152, in that he knowingly and fraudulently made a false oath in relation to the bankruptcy proceedings by testifying, under oath, to the effect that: his wife had purchased a certain ten karat diamond ring with her own funds within six months prior to the time the ring was pledged to the Provident Loan Society on June 22, 1971; that the ring was not purchased with the intention of pledging it to obtain funds for the bankrupt; and that the bankrupt had no knowledge of the purchase of the ring until some time thereafter. The trustee alleged that, in fact, the bankrupt committed a false oath as to these facts; that in fact the ring was not purchased with the wife's funds but on credit from Gimbel Brothers, Inc. on June 21, 1971; that such date was just one day before it was pledged to the Provident Loan Society; that the bankrupt, contrary to his testimony, requested his wife to pledge the ring and turn the proceeds of the loan over to him the day after the sale, thus according to the trustee, evidencing intent of the bankrupt to pledge the property (JA3).

Bankruptcy Judge Edward J. Ryan concluded that that the bankrupt had, indeed, violated 18 U.S.C. §152 by his failure to list the ring as an asset, even though he did list a debt to Gimbels Brothers, Inc., in excess of $16,000.00 and that the bankrupt also had committed perjury, concluding that the testimony of the bankrupt and his wife did not "have a ring of truth" (JA250). He concluded that the real party in interest as to the purchase of the ring was the bankrupt (JA250-251). His decision to deny discharge for violation of 18 U.S.C. §152 was affirmed by the District Court for the Southern District of New York, which held, in essence, that the findings of the Bankruptcy Judge were not clearly erroneous.

ARGUMENT

POINT I

THE BANKRUPT DID NOT VIOLATE 18 U.S.C. §152 BECAUSE HE DID NOT KNOWINGLY AND FRAUDULENTLY FAIL TO LIST THE DIAMOND RING IN HIS STATEMENT OF AFFAIRS.

In order for a bankrupt to be found in violation of 18 U.S.C. §152, and to be denied discharge by virtue of §14c(1) of the Bankruptcy Act, the trustee must prove that the omission of assets from the bankrupt's schedules was done "knowingly and fraudulently" and the evidence of concealment must be clear. *In Re Agnew*, 225 F 650 (N.D.N.Y., 1915). If the trustee fails to prove that the bankrupt knowingly and fraudulently intended to conceal assets of the estate, he fails to prove the elements of the offense under 18 U.S.C. §152 and the specification must be dismissed. *Tancer v. Wales*, 156 F2d 627 (2d Cir., 1946); *Shelby v. Texas Instruments Co.*, 280 F2d 349 (5th Cir., 1960).

Testimony elicited at the hearing on the specifications indicated that upon the advice of bankrupt's counsel, the debts of his wife were included in his schedules (JA101, 102, 106). Mr. Krause, counsel for the bankrupt, advised him that this procedure should be utilized for two reasons (JA98). One is that due to the lifestyle of the bankrupt and his wife, the purchase of the ring could, under New York law, be considered a "necessary" which must be included in his statement of affairs as his debt. *Gimbel Bros. v. Steinman*, 114 N.Y.S. 2d 603, 202 Misc. 858 (1952); (JA98).

The second reason for the inclusion of the debt was that it was the practice of the bankrupt's counsel to be "ultraconservative" in preparing bankruptcy schedules and thus, in their opinion, it would be the safer practice to list the debt of the wife as his own, even if it turned out that the debt was indeed not his responsibility, rather than be charged with filing of a false petition.

Matter of Hannan, 127 F.2d 894 (7th Cir., 1942); Vol. 1A *Collier on Bankruptcy*, 14th ed. ¶14.20 at 1324; (JA101-102).

Further testimony elicited from the bankrupt's counsel indicated that counsel not only knew of the existence of the debt, but also that the debt was incurred by the purchase of a diamond ring, although counsel stated he did not know that it was ten karats (JA135). Counsel was also told by the bankrupt that Mrs. Faye purchased the ring (JA138).

Based on the testimony of bankrupt's counsel, the bankrupt had made a full disclosure of his affairs and he had the right to rely on advice of counsel as to whether or not to list this information in his schedules. Since the debt that represented the purchase of the diamond ring was listed in his schedules (in the amount of $16,465.02), the bankrupt's failure to list the ring does not constitute knowing, fraudulent concealment by the bankrupt.

Therefore, the bankrupt did not make a false oath in his verified bankruptcy petition, punishable under 18 U.S.C. §152, and requiring denial of discharge by virtue of §14c(1), because he had no intent to "knowingly and fraudulently" conceal assets. See *Thompson v. ECK*, 149 F. 2d 631 (2d Cir., 1945).

POINT II

THE TESTIMONY ELICITED IS INSUFFICIENT AT LAW TO PROVE THAT THE BANKRUPT MADE A FALSE OATH PUNISHABLE UNDER 18 U.S.C. §152.

A. Bankrupt's Testimony That His Wife Purchased The Diamond Ring With Her Own Funds Within Six Months Of Its Being Pledged When It Was Done By The Use Of A Credit Card Is Irrelevant And Immaterial, And, Therefore, Not Within The Statutory Prohibition.

At the adjourned first meeting of creditors held on September 19, 1972, the bankrupt stated that his wife had purchased with funds she saved, a diamond ring within six months of its being pledged, with the pledged funds being turned over to the bankrupt (JA4-6). The record indicates that the ring was purchased on or about June 21, 1971 and then pledged by the wife with Provident Loan Society on June 22, 1971 (JA25). Thus the statement of the bankrupt that the purchase was within six months of its being pledged is technically correct and does not constitute a false oath. *People v. Smilen,* 33 N.Y.S. 2d 803 (1942).

In fact, the testimony should have revealed that Gimbels Bros. does not sell merchandise on 'credit memo" (JA167). There are only three types of sale transactions sanctioned by Gimbels; cash sales, C.O.D., equivalent to cash sale, and credit card transaction. The affidavit of Robert J. Mulligan, Assistant Secretary of Gimbels, New York Division, and Chief of the New York store operations, which is reproduced in the addendum to the joint appendix, states unequivocally that the purchase of the ring was made by Mrs. Faye, and that credit was extended solely to Mrs. Faye on her credit card account. Clearly, as far as Gimbels, the vendor, was concerned, the purchase was made by Mrs. Faye and, in fact, the ring became her personal property, to exercise such dominion as she believed appropriate.

For there to be a concealment of assets, the asset must belong to the bankrupt, so that it would pass to the trustee. *Thompson, supra; Collier, supra,* par. 14.2 at page 1320. To be liable under 18 U.S.C. §152, the false statement must be material and effect the estate of the bankrupt. *In Re Streiker,* 360 F. 2d 765 (3d Cir., 1967); *Tancer, supra.* Thus, since the asset is outside the estate, the testimony of the bankrupt as to its disposition is irrelevant and immaterial, and, therefore, does not constitute a false oath under 18 U.S.C. §152 or an offense that would deny discharge under §14c(1). *Bauman v. Feist,* 107 F 85 (8th Cir., 1901).

B. Bankrupt's Testimony That He Requested His Wife To Pledge The Ring Is Merely An Inconsistent Statement And Does Not Constitute A False Oath.

At the adjourned first meeting of creditors held on September 19, 1972, the bankrupt stated that he requested his wife to pledge the ring (JA6). In later proceedings he stated that he did not know of the purchase of the ring nor of its being pledged (JA56), although he had asked his wife to pledge other pieces of jewelry (JA55-57). As the testimony indicates, the wife of the bankrupt had on several occasions prior to June 21-22, purchased items of jewelry without the knowledge or consent of the husband, and that when he found out about the purchases, he returned these pieces (JA4-5, 169, 172). Testimony of the bankrupt also indicates that on June 22, 1971, he asked his wife to pledge jewelry with the Provident Loan Society even though he had asked her to do so on June 16, 1971, not knowing that she had purchased the ring on the previous day (JA48-49). When he found out that the ring was pledged, he attempted to return it to Gimbels (JA59-61). He told the Court that it was a mistake that the ring was pledged (JA48). The bankrupt further testified that the testimony of September 19, 1972 was in error and he so stated for the record (JA68-69). This testimony was substantiated by his wife (JA181).

A false statement will not be sufficient basis for denial of a discharge unless it has been knowingly and fraudulently made. If, on examination, a bankrupt testifies falsely because of mistake, a discharge will not be denied. *In Re Eaton*, 110 F 731 (N.D.N.Y., 1901); *Scharcoff v. Schiefflin & Co.*, 70 F. 2d 725 (2d Cir., 1934); *Collier, supra*, par. 14.29 at 1349. As indicated above, the inconsistency in appellant's testimony was immaterial, since the ring in question was not an asset of the bankrupt's estate, and the "false" portion of the bankrupt's testimony was the result of error, not culpable intent.

POINT III

THE TRUSTEE FAILED TO MEET HIS BURDEN OF PROOF UNDER BANKRUPTCY RULE 407 WITH RESPECT TO 18 U.S.C. §152, SINCE A FINDING AGAINST THE BANKRUPT MAY LEAD TO CRIMINAL SANCTIONS.

In order for the trustee to meet his burden under Rule 407, it has been held he "must prove the facts essential to his objection" by a preponderence of the evidence. California Evidence Code §500, *In Re Guilbert's Estate*, 180 P. 807, 46, C.A. 55 (1920). However it seems anomalous, and also a violation of substantive due process, for a party to be able to prove an allegation by a mere preponderence of the evidence, where a finding against the bankrupt subjects the bankrupt to criminal liability and possible imprisonment. The better rule should be, although it is not uniformly followed. See *Rice v. Mathews*, 342 F.2d 301 (5th Cir., 1965) that where a bankrupt is confronted with an offense under the Bankruptcy Act, that if proven, would open the door to criminal liability, the proponent of the allegation should prove the allegation by clear and convincing evidence, beyond a reasonable doubt, not by a mere preponderance of the evidence. If the allegation to be proven under the section is the same for both criminal and civil proceedings, the proof required to

sustain the allegation should be the same. In addition, the Court refused to order independent counsel for the bankrupt even though it knew of a potential conflict of interest in violation of the code of professional responsibility and possible criminal sanctions against the bankrupt (36) (JA35-36). We respectfully submit that appellant was placed in an untenable position by virtue thereof, especially since the burden of proof may be shifted to the bankrupt.

Here the trustee had the burden of proving the facts essential under 18 U.S.C. §152. *Union Bank v. Blum*, 460 F.2d 197 (9th Cir., 1972). The main element of this statute is that the bankrupt "knowingly and fraudulently" committed a false oath. The trustee can use the testimony elicited from the bankrupt as the basis of his allegation and, therefore, shift the burden of proof onto the bankrupt. *Matter of Margolis*, 23 F. Supp. 735 (S.D.N.Y., 1937). If the bankrupt either meets that quanta of evidence that the proponent first raised or exceeds that amount, then the proponent has, in fact, failed to meet his burden and the Court must find for the bankrupt. *Troeder v. Lorsch*, 150 F 710 (1st Cir., 1906). Based on the record, the bankrupt had demonstrated that he had no intent to conceal assets or to make a false oath. The failure to schedule the ring as an asset was done through oversight or neglect by his counsel, therefore, indicating a lack of any fraudulent intent. *Thompson, supra* at 634.

With regard to the third specification, the testimony of the bankrupt, a fair reading of the testimony of Mrs. Faye and the bankrupt's counsel shows no intent to give a false oath, and that the original statements were made in error. Therefore, since the evidence is not clear that the bankrupt violated 18 U.S.C. §152 in any manner, the bankrupt is entitled to discharge. *In Re Beesen*, 335 F. Supp. 636 (W.D., Ark., 1972); *Humphries v. Friendly Finance Discount Corp.*, 469 F. 2d 643 (5th Cir., 1972).

POINT IV

THE BANKRUPTCY JUDGE ACTED ARBITRARILY IN NOT DISMISSING SPECIFICATIONS ONE AND THREE, AND HIS FINDINGS WERE CLEARLY ERRONEOUS.

Judge Edward J. Ryan indicated in his decision that the events as told by the bankrupt and his wife were in his opinion unbelievable and he refused to give any credence to their testimony (JA250-251). Instead, he based his decision on the testimony of the salesman who sold the ring to the wife, (JA8-21), even though his testimony conflicts with that of the bankrupt in two essential areas, in one which the salesman was patently in error. The salesman stated that the sale had taken place on June 29, 1971, which, if true, would be seven days after the ring was pledged (both parties had stipulated that the ring was pledged on June 22, 1975) (JA18, 25). The other area of disagreement is that the salesman stated that the bankrupt was present on the date of the sale of the ring (JA18), when both the bankrupt and his wife had testified that the bankrupt was not present. Judge Ryan was suspicious of the events surrounding the purchase of the ring, which he erroneously characterized as being sold "on memo" four times in his decision, and its subsequent pledge, even though there is testimony by both the wife and her husband that she on several past occasions had acted in a similar manner in buying articles of jewelry without the knowledge or consent of her husband (JA4, 178-181). The salesman, also, stated that the ring was sold by use of a Gimbel's credit card and was not sold on "memo" (JA19). Based on these suspicions, however, the judge granted the trustee's petition to deny discharge (JA 250-251). This was clearly erroneous as against the weight of the credible evidence.

First, inferences alone cannot be the basis for refusing a discharge in bankruptcy. *In Re Tuman,* 58 F. Supp 210 (D.C.N.J., 1944). This is true where there is no evidence to support such inferences or reasonable explanations are given, as

in the instant case, *Tuman, supra.* Second, a bankrupt cannot be denied a discharge on any general equitable considerations. Discharge can only be denied if one of the statutory grounds of objection are proved, which the trustee has not done here. *Shelby* v. Texas Instruments Co., supra at 355; *Collier, supra* 14.02 at 1254. Also it is not so much the acts of the bankrupt that will prevent discharge, as it is the intent with which he acts. *In Re Pioch,* 235 F.2d 903 (3d Cir., 1956). Mere suspicious circumstances are not sufficient to deny discharge. *Matter of Howard,* 180 F 399 (2d Cir., 1910). The debt was listed in the bankrupt's schedules, even though the ring was not. That fact negates wrongful intent.

In conclusion, it is clear from the record, that the Bankruptcy Judge acted erroneously in granting the trustee's petition and the drastic relief sought therein.

POINT V

THIS CASE SHOULD BE REMANDED TO THE BANKRUPTCY JUDGE FOR FURTHER PROCEEDINGS IN THE INTEREST OF JUSTICE.

In our argument above, we referred to the critical issue of the circumstances under which Mrs. Faye purchased the diamond ring which allegedly should have been listed as an asset of the bankrupt. We referred also to the Bankruptcy Judge's reliance on the fact that Mrs. Faye obtained possession of the ring on a "memo" sale. After the hearing before the District Judge, when present counsel entered the case, we learned of the existence of a complaint in an action by Gimbels Brothers against the appellant and his wife. We have set forth that complaint in the addendum to the appendix, and think that it is significant that Mrs. Faye was sued in her own name for a purchase she made, according to Gimbels. After examining the testimony set forth in the transcript, we made inquiry of Gimbels and found that Gimbels had no procedure for memo sales, but that the sale, in

fact, was made to Mrs. Faye on her own credit and charged to her credit account with Gimbels after approval of her credit by Gimbels. We have set forth a copy of that affidavit in the addendum to the joint appendix. We believe it is significant in terms of the Bankruptcy Judge's reliance on the issue of who had ownership of the ring and under what circumstances it was purchased.

Ordinarily, a motion for a new trial before the Bankruptcy Judge would be in order, but in view of the jurisdictional questions raised by virtue of the appeal having progressed to this stage, we respectfully requested that failing reversal on the law, this court should remand the case to the Bankruptcy Judge in the interests of justice.

It is respectfully submitted that the two documents set forth in the addendum are of enough significance so that irrespective of the burden of proof appropriate to the Bankruptcy Court's proceeding, had this information been before the Judge the result would probably have been different. The bankruptcy judge's reliance on the testimony of the salesman of the jewelry would, in our opinion, have been changed by presentation of these two documents. It is quite possible, in our view, that some of the mystery surrounding the purchase of the ring would have been disspelled by an officer of Gimbels having testified fully with respect to the procedure under which the ring was sold. The Court's suggestion for further inquiry of Gimbel's Credit Manager, Mrs. Goodman (JA65) indicates that there was sufficient confusion surrounding the sale to require clarification. The information we have set forth would have been most helpful to the Court, in our opinion.

CONCLUSION

THE ORDER OF THE DISTRICT COURT AFFIRMING THE BANKRUPTCY JUDGE SHOULD BE REVERSED ON THE LAW AND FACTS. FAILING REVERSAL, THE CASE SHOULD BE REMANDED TO THE BANKRUPTCY COURT IN THE INTEREST OF JUSTICE.

Respectfully submitted,

SHAW AND LEVINE

Dated: New York, New York
October, 1975

STATE OF NEW YORK)
: SS.
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 296 Richmond Avenue, Staten Island, N.Y. 10302. That on the 3 day of Oct , 1975 deponent served the within BRIEF upon Kenneth Utt

attorney(s) for PLA - Appellee

in this action, at 1 Battery Park Plaza N.Y.C.

the address(es) designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
.....
ROBERT BAILEY

Sworn to before me, this
3rd day of Oct , 1975.

William Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976